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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

National Intelligence Council

DDI #3591-82
29 April 1982

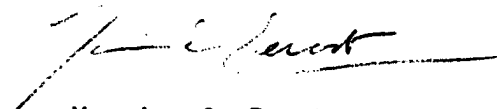
MEMORANDUM FOR: Director of Central Intelligence

VIA: Chairman, National Intelligence Council

FROM: Maurice C. Ernst
National Intelligence Officer for Economics

SUBJECT: A System for Controlling Credits to the Soviet Union

This paper outlines a proposed system for controlling credits to the Soviet Union and the rationale for such a system, in response to your request. I believe the proposal is generally consistent with the views of the State and Treasury experts, although I have not coordinated with them. I await your guidance before considering any further dissemination for this paper.



Maurice C. Ernst

Attachment,
As stated

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SUBJECT: A System for Controlling Credits to the Soviet Union

Purpose

The purpose of the Buckley Mission is to establish a system in the Western Alliance to control the volume and terms of Western credit to the USSR, and consequently, to minimize the net flow of Western capital to that country. A reasonable degree of control would include:

- Sufficient information--on commitments, drawings, repayments, debt, etc.;
- Quantitative limitations on official lending--on volume of commitments, drawings, indebtedness;
- Restraints on credit terms--eliminating or reducing interest rate subsidies and limiting the proportion of loans covered by government guarantees.

Criteria

There are two principal reasons for any system designed to control credits to the USSR:

- a financial criterion--the system must prevent overexposure of Western banks and governments, such as has already occurred on lending to East European countries, and the potentially costly claims on Western budgets if government guarantees on credits have to be made good;
- a political/security criterion--the system should put added pressure on the Soviet authorities to change their priorities away from activities that threaten Western interests.

There is general agreement on the first of these criteria, but not on the second. Yet the first criterion is too loose to become the sole basis for an effective international agreement.

The difficulty Moscow has encountered in obtaining new medium- and long-term Eurodollar credits in the past year or so is caused not only by its own hard currency problem, but also by the worsening of East-West political relations. It will become more difficult to prevent large Soviet Eurodollar borrowing when, presumably in 1983-84, Western economic recovery temporarily eases the Soviet hard currency bind by pushing up demand for and prices of Soviet goods in Western markets. Although the long-term outlook for Soviet exports is poor, we cannot prevent Moscow from reentering the long-term Eurodollar market, at least during the next two or three years, without some new negative political signal from Western governments.

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Although most of our allies are willing to recognize the relevance of political/security criteria to policy concerning credits to the USSR, they differ from us a great deal on what these criteria should be. They want to avoid at all cost appearing to engage in any sort of economic warfare against Moscow, or of pursuing a policy designed to reduce trade with the Soviet Bloc. They are probably willing, however, to accept credit policies more restrictive than financial criteria alone would warrant, so long as the political/security motives are not made explicit in public.

Another problem concerns the neutral countries--Switzerland, Sweden, Austria, etc.--which are substantial lenders to the USSR but are not willing to participate formally in a politically-motivated process of credit restriction.

Use of Existing International Organizations

No international organization exists which could organize the system for controlling credits to the USSR on the basis of both financial and political/security criteria. NATO, OECD, and the Bank for International Settlements (BIS) all have a role to play, but cannot do the entire job.

NATO

For 30 years NATO has been the focal point for allied discussions of Soviet Bloc financial problems and for collection and presentation of basic data on Soviet and East European credits and debt. NATO offers a number of advantages, including:

- a natural focal point for discussion of political/security concerns about credits to the Soviet Bloc;
- long experience in collecting and organizing data on this subject;
- a major representative role for the military/security/intelligence establishments in the member countries.

There are also disadvantages to using NATO, including:

- Japan and several European countries are not members;
- National East-West economic and financial policies are handled primarily through other channels;
- NATO economic/financial work has only weak links to the NATO political level and is poorly staffed.

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OECD

The OECD's advantages and disadvantages for this purpose are almost the opposite of NATO's. In its favor, the OECD:

- is generally well staffed and has a strong data base capability, although not at this point on East-West matters;
- includes all interested countries;
- focuses on economic and financial policy issues.

But the OECD's strengths are also sources of weakness, including:

- great difficulty in going beyond economic and financial criteria and in differentiating between the Soviet Bloc and other groups of countries;
- a tendency toward a lowest common denominator.

Bank for International Settlements (BIS)

The BIS provides an informal forum for meetings of central bankers and a voluntary collection system for statistics on international banking. It provides data unavailable anywhere else, and includes politically neutral countries such as Switzerland. But by its nature it cannot be a specific instrument for discrimination against the Soviet Union on political/security grounds.

A Possible New International System

Since none of the existing international organizations fit the bill, a new organization will be needed. It is highly unlikely that our allies will support creation of a new formal organization. They may be willing to go along with a new informal organization, such as COCOM. The question is how should this organization be structured and what should be its characteristics?

Like COCOM, the new organization should be informal, with minimal, if any, permanent staff, and would decide by unanimity or consensus. Unlike COCOM, it would deal with credit policy guidelines, rather than individual cases, and would include only the most important countries. Let us name it the Credit Policy Coordination Committee (CPCC).

The principal function of the CPCC would be to coordinate and develop joint policies concerning credit to the USSR and to create a mechanism for monitoring and implementing agreed policies. The CPCC should not supplant the functions of existing organizations (NATO, OECD, BIS), but rather

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should make use of these functions to facilitate policy implementation. Although the work of the CPCC would be focused on the USSR, the rest of the Soviet Bloc could not be ignored because of the close linkages between the USSR and Eastern Europe. Moreover, establishment of a CPCC would facilitate allied discussion of East European financial issues and development of coordinated policies concerning Eastern Europe.

Membership

The central objective of policy coordination requires that the CPCC be of manageable size (with only a few countries). An organization in which nearly all of OECD countries were represented, would be too unwieldy and would include neutrals who could not officially accept political/security criteria as policy determinants. Even an organization limited to the NATO countries and Japan would be too cumbersome for this purpose.

This suggests that the membership of CCPC should be limited to the Seven Economic Summit countries--a group of manageable size, whose members dominate economic relations with the Soviet Bloc, and whose national interests and perspectives concerning relations with the Bloc range across the entire Alliance spectrum. Agreement among the seven would virtually assure agreement within NATO, although the smaller countries would resent being excluded from the in-group. There would then be little chance of serious policy divergences from non-NATO OECD countries of any importance.

Although Western industrial countries outside the CCPC might not want to be bound by any agreed formula for restricting credits to the USSR, most would almost certainly be cooperative. This is even true of the Swiss, who are members of neither NATO nor the OECD.

Data Collection and Monitoring

By concentrating on policy coordination and monitoring, the CCPC could use existing organizations to collect statistics as well as to elicit the cooperation of other countries. For example:

- NATO could build on its existing statistical collection system on government-guaranteed credits to meet the needs of a new monitoring system. This would require not only more complete and timely data reporting from the member countries but also an upgrading of the NATO/ECONAD staff.
- The OECD could then add to the NATO reporting to cover its non-NATO members.
- A coordinated approach could then be taken to the BIS for improved data on private lending and debt.

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Methods for Regulating Credits

In order to avoid becoming just a loose discussion group, the CCPC would have to develop some sort of formulae for regulating credits to the USSR and possibly the Soviet Bloc in general, and establish a subordinate Monitoring Group.

The formulae could establish limits on:

- New credit commitments;
- Drawings on credits;
- Debt or exposure;
- Terms (interest rates, maturities, percent of project cost covered by government-guaranteed credits).

The functions of a Monitoring Group would be to:

- Monitor performance for the seven members in accordance with the formulae;
- Monitor performance of non-member countries;
- Coordinate efforts to enhance data collection effort in other organizations.

Such activities almost certainly would also convey negative signals to the private financial markets and prevent Western governments from providing larger guaranteed credits to compensate for a low level of private credits. Thus, the main objectives would be achieved in both the public and private markets.

Representation

To be effective the CCPC would require regular meetings at the Under-secretary level. The Foreign Affairs and Financial Ministries inevitably would play the largest role, but military and commercial interests also should be part of the process.

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